United States Court of Appeals

for the Second Circuit

APPELLEE'S REPLY BRIEF

76-4112

United States Court of Appeals

FOR THE SECOND CIRCUIT

ESTATE OF LUDWIG NEUGASS, Deceased, HERBERT MARX, JACQUES COE, JR., and CHASE MANHATTAN BANK, N.A., Executors,

Petitioners-Appellants,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES TAX COURT

REPLY BRIEF FOR PETITIONERS-APPELLANTS

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FOR THE SECOND CIRCUIT

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Appellee's brief argues that the bequest received by Mrs. Neugass did not qualify for the marital deduction because (a) the evidence introduced below shows that it was the decedent's intent to create a bequest in the form of a vested life estate with a terminable power of appointment (RA 15-17)* and (b) if the will in fact gave Mrs. Neugass a choice between alternative bequests, as appellants have maintained, the interest given to the spouse should nevertheless be deemed terminable because of the necessity that the spouse affirmatively exercise this election. (RA 22-24)

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* References to the Brief for Respondent-Appellee are cited as "RA .": references to the Brief for Petitioners-Appellants are cited as "PA ."

The first argument misinterprets the testimony concerning the factors which were uppermost in the testator's mind when the will was drafted. These clearly indicate that he intended his wife to have a simple choice between various alternatives. (POINT I, *infra*)

Similarly, appellee's interpretation of the authorities cited by appellants, both decisional and statutory, is contrary to the overriding Congressional intent that the marital deduction provisions be *uniformly* applied to all types of property interests passing to a spouse, whether pursuant to a will or state law. The position taken by appellee would create an inequity in the administration of the marital deduction provisions of the Code, in that the same act, such as the exercise of an election, will be treated differently, depending upon the source of the spouse's authority to so act. (POINT II, *infra*)

ARGUMENT

POINT I

Decedent's will granted his surviving spouse an election between alternative bequests.

A. Testator's use of the term "elect" created an ambiguity in the will which should be resolved by reference to extrinsic evidence concerning testator's intent.

Appellee's brief (RA 32) argues that the language used by decedent in Article FIFTH is "plain and unambiguous," and that extrinsic evidence as to the testator's underlying intent should be disregarded, citing *In re Estate of Fried*, 445 F.2d 979 (1971), *aff'g* 54 T.C. 805 (1970), *cert. den.*, 404 U.S. 1016 (1972) and *Estate of Opal* v. *Commissioner*,

54 T.C. 154 (1970), *aff'd*, 450 F.2d 1085 (2d Cir. 1971). Appellee therefore contends that *Estate of Tilyou* v. *Commissioner*, 470 F.2d 693 (2d Cir. 1972), relied upon by appellants (PA 10, 13), is inapposite, since the *Tilyou* case dealt with a will containing ambiguous language.

We submit that appellee's citations of *Fried* and *Opal* beg the question. Nowhere does appellee define what constitutes an ambiguity nor what criteria it has used in reaching its conclusion that the language of Article FIFTH is "plain and unambiguous". In *Tilyou*, the Court held that the phrase "entitled to" was ambiguous, since it might mean "entitled to possession" or "entitled to distribution" which would make the bequest terminable, or, on the other hand, "entitled as of right" which would not disqualify the bequest. The Court concluded that ambiguity existed on the sole ground that the "entitled to" clause had never been interpreted under New York law.

In the instant case, appellee's brief cites not one authority which specifically interpreted the effect of the term "elect" under New York law. We submit that the term may be interpreted either as a power of appointment or as a pure choice among alternatives, and that, as in *Tilyou*, the lack of New York precedent as to its proper interpretation mandates that extrinsic evidence be considered.

In fact, the Neugass will contains additional elements of ambiguity not present in *Tilyou*. Whereas the *Tilyou* court held the "entitled to" clause ambiguous merely because it had never before been interpreted under New York law, the Neugass will contains two additional elements which should cast doubt on the automatic assumption of the appellee, and the Tax Court below, that "elect" and

"power" are synonomous. First, as we have shown in our main brief (PA 8), the provisions of Article SIXTH (d), which created a marital deduction trust for Mrs. Neugass, specifically used the terms "appoint" and "power". Article FIFTH, on the other hand, uses the different term "elect". Second, the interpretation urged by appellee, that Article FIFTH should be viewed as a vested life estate with a power of appointment, is put into question by testator's directive that the *daughter's* right to elect a fee ". . . shall take effect if and only when her life use has begun." In the wife's case, no such directive appears. The wife's right to elect is independent of and not conditioned on a pre-existing life estate.

If anything might be concluded by what appellee describes as the "plain and unambiguous" language used by testator, it is that *no* power was intended at all but that testator meant to give his wife nothing more than a choice between alternatives. Clearly, therefore, appellee's reliance on *Fried* and *Opal,* rather than *Tilyou,* is misplaced; the term "elect" used by testator is clearly open to various interpretations, especially when viewed in the context of the surrounding testamentary language, and testator's intent should therefore be determined only after careful scrutiny of the extrinsic evidence available to the Court.

B. *The evidence submitted below indicates that the testator intended to give his wife a simple choice between alternatives rather than a vested life estate with a power of appointment.*

The uncontradicted evidence concerning testator's intent proves that his primary concern was to provide his wife with complete freedom of choice between independent alternatives. As appellee repeatedly quotes from the record in its brief (RA 36-37), decedent desired to give his wife

"complete flexibility"; she could take the art outright, or she could take a life estate, or her daughter or the Foundation could take the art. Appellee's attempt to explain this draftsmanship as "post-mortem tax and estate planning" (RA 38) simply does not conform to the testimony below and does not adequately explain the specific structure of the bequest as drafted.

In our main brief (PA 7), we pointed out that the draftsman perceived possible difficulties in preserving the desired flexibility if a fee were given with a right to renounce, since, if the widow might desire to retain a life estate rather than a fee, this would require a partial renunciation from a greater to a lesser estate. It was not clear under New York law whether such a renunciation would be permissible at all. That this was the concern which prompted the drafting of Article FIFTH is attested to by the draftsman in his testimony on this specific question (JA* 90, line 17-92).

Appellee's discussion of the possible tax ramifications which it believes to have been the true motive behind Article FIFTH does not explain why the six-month time limitation was imposed. If testator's sole concern were to remove the art from his wife's estate and yet preserve her right to take a fee, why limit her right of choice to six months? As we have previously shown, (PA 7-8), testator's primary concern was not with the tax aspects of the election, but with the possibility that New York law would not allow a renunciation at all from a greater to a lesser estate. Testator therefore gave his wife a life estate with a right to choose a fee instead. This was designed to allow the widow

* References to the Joint Appendix are cited as "JA ."

a "renunciation" of a lesser estate in favor of a greater estate, which is in effect an "election"; but since the only known period under New York law in which renunciations were permissible, *i.e.* intestate renunciations, was six months, such a time limitation was included in the will in order to insure that the election would be effective.

This concern that the "election" conform to the requirements of a valid renunciation was attested to by the draftsman (JA 91):

> "And it seemed to me at the time, and still does, that there—it is much akin to being offered an apple and an orange. And you can say, 'here's an apple and an orange. Take one or the other of them. And if you take the apple, you are rejecting, disclaiming, renouncing the orange'—if you are limited to one choice or the other. *It is for that reason that the art collection was not left outright with a power of renunciation because we didn't know where that would lead to under the law of New York.* The six-month provision is clearly derived from what was then the only indicia of renunciation, disclaimer of [sic] election or what have you—that there was in the State of New York. [Emphasis added]

Thus, it is apparent that if not for the possibility of running afoul of the law of New York with regard to renunciations, the testator would have given his spouse a fee with a right to renounce to a life estate, which would have accomplished the same tax objectives which appellee claims to have been the motive of Article FIFTH and would at the same time clearly qualify the bequest for the marital deduction. The only explanation for the drafting of Article FIFTH

in its *entirety* as it appears in the Will is the testator's concern that the alternatives he wished to provide his wife not be precluded by New York law. We quote again from the *Tilyou* decision, which summarizes exactly the relevant factors applicable to interpreting the Neugass will:

> "Given the uncertain impact of this phrase in New York law, the receptiveness of New York courts to extrinsic evidence to determine the circumstances known to the testator when he drew his will, and the substantially uncontroverted explanation of the reasons for including this clause in the Will (which explanation clearly established that Francis S. Tilyou did not *intend* to create a terminable interest in his widow), we believe that the clause should not be read to create a terminable interest in this will." [emphasis in original] [470 F.2d at 699]

As in *Tilyou*, the testator desired to leave his wife an interest which would qualify for the marital deduction, and it is only because of unrelated uncertainties with regard to New York law that the will was drafted in a more cautious fashion. Recognition of the underlying motives of the testator leads to the obvious conclusion that he intended to leave his wife two simple alternatives, rather than a vested life estate with a power.

The court should also be guided in its interpretation of the will by *Northeastern Pennsylvania National Bank & Trust Co.* v. *United States*, 387 U.S. 213 (1967), cited in our main brief (PA 12). *Northeastern* stands for the general proposition that in the application of the marital deduction rules, courts should be guided by:

> "Congress' intent to afford a liberal 'estate-splitting' possibility to married couples, where the deductible half of the decedent's estate would ultimately—if not consumed—be taxable in the estate of the survivor . . ." [387 U.S. at 221]

Appellee is simply mistaken in its contention (RA 39) that the liberality intended by Congress was applicable only to the "specific portion" rule which was the immediate problem in *Northeastern*. Cases subsequent to *Northeastern*, having nothing at all to do with the "specific portion" issue, have consistently cited this aspect of the *Northeastern* case. *See, e.g., Estate of Tilyou* v. *Commissioner*, 470 F.2d 693 (2d Cir. 1972), at 695; *Estate of Mittleman* v. *Commissioner*, 522 F.2d 132 (D.C. Cir. 1975), at 140.

Since the artworks specifically elected by Mrs. Neugass will in fact be fully taxed in her estate, the liberality urged by *Northeastern* should be applied to the instant case in the Court's search for the proper interpretation of the will.

POINT II

The necessity that the spouse "elect" which of the two alternatives she will take does not make an otherwise non-terminable bequest so elected terminable.

Our basic position is that if the court finds the will to be in the form af alternative bequests, the artworks actually chosen in fee should qualify for the marital deduction. In our main brief we cite many authorities which have held, in the context of a widow's right of election, that the necessity of choosing does not introduce any contingencies which make the bequest conditional and thus terminable. Appellee's attempts to discredit this argument are all plainly in error, and are based on misunderstandings of the sources cited.

A. *The necessity of choosing does not make a bequest conditional under New York law.*

Appellee cites New York law (RA 20-21) for the proposition that the requirement of choosing makes the alternative bequest contingent rather than absolute. The authorities cited by appellee do not specifically refer to this requirement as a contingency; the brief merely extrapolates the general language of the New York Estates, Powers and Trusts Law with regard to the occurrence of an "uncertain event" and assumes that the act of choosing is such an event. But *Matter of Jacobsen*, 61 Misc.2d 317, 306 N.Y.S. 2d 290 (Surr. Ct., N.Y. Co. 1969), *aff'd*, 33 App. Div. 2d 760, 306 N.Y.S.2d 297 (1st Dept. 1969), is a sufficient answer to this contention. In *Jacobsen*, the will provided two alternative provisions for the widow, with the proviso that she would be presumed conclusively to have chosen

the first alternative if she did not choose the second within six months. The second was a bequest in trust designed to preclude the spouse's right to elect to take against the will under EPTL §5-1.1. The widow nevertheless claimed the right to elect against the will, arguing that the second alternative was conditional, since it required the act of choosing, and was therefore not an "absolute disposition" as required by the statute. Indeed, there is a long line of authority in New York, especially *Matter of Byrnes*, 141 Misc. 346, 252 N.Y.S. 587 (Surr. Ct., N.Y. Co. 1931), *aff'd*, 235 App. Div. 782, 257 N.Y.S. 884 (1st Dept. 1932), *aff'd*, 260 N.Y. 465 (1933), holding that the widow's right of election will not be defeated where "any condition or contingency whatsoever" appears in the testamentary provision provided in lieu of the widow's elective share.

Nevertheless, the court in *Jacobsen* held that the bequest to her, while in alternative form, precluded her right of election in spite of the necessity of choosing one of the two alternatives. As we quoted in our main brief (PA 17), the court stated:

> ". . . she has the free choice of two alternatives, with no burden other than to say what she wants." [61 Misc. 2d at 320; 206 N.Y.S. 2d at 293]

In effect, the court is stating that the alternative actually chosen by the widow is an "absolute" disposition and is *the* operational bequest of the will. The authorities cited by appellee (RA 20-21) simply have no reference to the necessity of election and, as *Jacobsen* illustrates, this requirement does not make a bequest taken by election conditional under New York law.

B. *The terminable interest rule should be applied uniformly to testamentary dispositions and state-created widow's rights.*

A major contention of appellee's brief (RA 27-32) is that there is a basic distinction between elective rights granted to a surviving spouse under state law and the right to elect when granted by the terms of the will. Appellee maintains that the legislative history of the marital deduction section is clear in this regard. However, as indicated in our main brief (PA 20-21, and especially Footnote 10, p. 21), the legislative history indicates the opposite conclusion. When Congress decided to allow a marital deduction for state-created rights, it sought to *equalize* the treatment of such rights with that of testamentary property passing to the spouse pursuant to a will. This is also the import of the quotation from *Hamilton National Bank of Knoxville* v. *United States*, 353 F.2d 930, 933 (6th Cir. 1965), *cert. den.*, 384 U.S. 939 (1966), on p. 31 of appellee's brief. To argue that the necessity of election is a non-terminable contingency for purposes of state-created rights but terminable for testamentary property is to say that Congress sought to discriminate in favor of state-created rights rather than to equalize it with testamentary provisions. There is no indication in the statute or in the legislative history that Congress had such a discriminatory purpose nor can any logic or equity be discerned in such a result.

The only problem with state-created rights perceived by Congress which would otherwise have disqualified such rights for marital deduction purposes is the "passing from the decedent" requirement. Congress therefore provided an exception, in Section 2056(e)(3), declaring that property passing to a surviving spouse pursuant to state law shall

be deemed to have "passed from the decedent." Congress did not provide an exception with regard to the terminable interest rule. This evidences Congress' belief that state-created rights would not run afoul of the terminable interest rule even if no special provisions were made for such rights. The terminable interest rule, as it presently appears in the statute, is couched in general language and is applicable to every right passing to the spouse, whether it be pursuant to a will or state law. Therefore, since the need to affirmatively elect in state law situations is not deemed a terminable contingency, as is evidenced by the authorities cited in our main brief, the inevitable conclusion must be that it should not be held terminable in the context of testamentary dispositions either.

Appellee has apparently misunderstood our argument in this regard. In its brief (RA 28-29) appellee argues that the terminability of the bequest must be determined from the will and not by reference to state-created widow's rights which the spouse might have taken under local law. Nowhere, however, did we argue that the bequest to Mrs. Neugass is nonterminable because she *could* have taken a non-terminable fee by electing against the will. Our point has always been that the treatment given to state-created widow's rights *in general* evidences the fact that the necessity of election, whether under or against a will, is not a contingency for purposes of the terminable interest rule so long as the bequest actually chosen is itself nonterminable. The legislative history and statutory provisions cited by appellee on pp. 28-29 of its brief are therefore totally irrelevant to the instant argument.

Appellee cites *Allen* v. *United States*, 359 F.2d 151 (2d Cir. 1966), *cert. den.*, 385 U.S. 832 (1966), and *Estate of*

Ray, 54 T.C. 1170 (1970) (RA 22) for the proposition that the necessity of election, in and of itself, makes a bequest terminable. Appellee admits, however, (RA 26) that the *Mackie* opinion, cited in our main brief, *Estate of Mackie* v. *Commissioner*, 64 T.C. 308 (1975), distinguished the *Allen* and *Ray* cases on the grounds that the election in those cases required the spouse to perform "acts *in addition to* merely accepting the bequest" (at 313; emphasis in original); in each case, the election required a commitment by the spouse to forego certain rights to the testamentary assets and execute a commitment as to the future disposition of those assets. As the *Mackie* court emphasized, these acts "had independent legal significance and constituted substantive limitations both on the power of acceptance and on the interest transferred." (at 313-314) Such an election imposed a burden far more onerous than in the *Jacobsen* case, *supra*, p. 9, for example, where the spouse had merely to indicate a choice without any "strings". Indeed, had the election in *Jacobsen* been as curtailed as in *Allen*, the bequest would have been deemed conditional:

> "Cases like *Matter of Filor's Will* and *Matter of Richmond's Will* . . . , where the condition of the widow's right to the trust was a burdensome one—that the widow must be successful in a litigation before she would be entitled to the benefits of the trust provision of the will—are inapplicable. Here, the only condition on the widow's right to the benefits of the trust of one-half of the net estate is merely to say that she wants it." [61 Misc. 2d at 321; 306 N.Y.S. 2d at 293-94]

Here, as in *Mackie*, the election was not "burdened" by any restrictions on the spouse's right of enjoyment. Indeed, the District Court opinion in the *Allen* case, 242 F. Supp.

687 (E.D.N.Y. 1965), affirmed by this court, specifically pointed out that the Allen bequest was terminable because the spouse received no more than a life estate with a limited power to consume (at 692). Where the bequest granted to the spouse pursuant to her election imposes restrictions on her right to enjoyment, she has in effect received less than the "full bundle of rights" she took in the instant case.

The *Mackie* case itself, therefore, should not be disregarded, since it too is distinguishable from *Allen* and *Ray* on these grounds. The holding of *Mackie*, that bequests by election are not terminable, should therefore be followed by this Court as well.

Furthermore, we submit that the entire approach of the *Allen* case, and of *Jackson* v. *United States*, 376 U.S. 503 (1964) before it as well, should no longer be followed by this Court, in light of the subsequent opinion of the Supreme Court in *Northeastern*. As pointed out above, the liberality urged by *Northeastern* is properly applicable to all aspects of the marital deduction, and should especially guide the Courts where, as in the instant case, the bequest passing to the widow will actually be fully taxed in her estate.

CONCLUSION

The order and decision of the Tax Court (Featherston, J.) should be reversed with directions to grant petitioners-appellants' prayer for relief and to enter an order eliminating the deficiency of $109,079.42 assessed against petitioners-appellants.

Dated: New York, New York
September 23, 1976

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Index No. 76-4112

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Petitioners-Appellants

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

The undersigned being duly sworn, deposes and says:

Deponent is not a party to the action, is over 18 years of age and resides at

1 Treetop Lane, Monsey, New York 10952

That on September 23, *19*76 *deponent served the annexed*

Petitioners-Appellants' Reply Brief on Scott P. Crampton, Assistant Attorney General, Tax Division, U.S. Department of Justice,

attorney(s) for Respondent-Appellee

in this action at U.S. Department of Justice, Washington, D.C. 20530

the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in—a post office—official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

Sworn to before me this 23rd day of September, 1976.

Witold da Stronie

WITOLD J. da STRONIE
Notary Public, State of New York
No. 41-4517529
Qualified in Queens County
Certificate filed in New York County
Commission Expires March 30, 1978

Benjamin L. Greenberger

The name signed must be printed beneath

BENJAMIN L. GREENBERGER